29 November 2019
Asia Pacific/New Zealand
Equity Research
Building Materials & Construction

JARDEN

Fletcher Building

(FBU.NZ / FBU NZ)

INCREASE TARGET PRICE

Rating	**NEUTRAL***
Price (28-Nov,NZ$)	5.17
Target Price (NZ$)	(from 4.97) 4.98
Market cap (NZ$mn)	4,315.0
Yr avg. mthly trading (NZ$mn)	123.0
Projected return:	
Capital gain (%)	-3.7
Dividend yield (net %)	5.0
Total return (%)	1.3

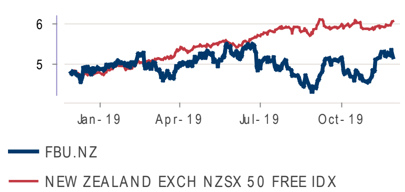
Target price is for 12 months.

Research Analysts
Arie Dekker
Grant Lowe

Guidance marginally down, but little else new

- **FBU has today announced maiden FY20 EBIT guidance of NZ$515-565 mn vs NZ$552 mn in FY19 on a** post-IFRS16, continuing basis. With mid-point consensus earnings at ~NZ$560 mn and our IFRS adjusted forecast at ~NZ$550 mn, we view this guidance as a modest downgrade to expectations for broadly flat FY20 earnings. On year-to-date trading and FY20 outlook there was little new since the FY19 result. Activity levels in NZ remain robust, albeit with some signs of easing in residential and infrastructure, whilst Steel earnings remain under pressure in a highly competitive market. FBU reiterated its target for NZ$100 mn in gross opex savings in Australia by FY21, with NZ$15 mn of FY20 savings weighted to the second half. However, with similar promises having been made in the past, and the backdrop of a declining residential market, the Australian turnaround is clearly not without significant risk and remains the key swing factor for near-term earnings. FBU noted pricing and margin pressure for Tradelink and Stramit, while activity levels are impacting Rocla and Iplex.
- **After the significant fire at the NZ International Convention Centre (NZICC)** it will be some time before FBU completes its assessment of damage and the impact on timelines, costs and previously announced provisions. Whilst FBU is holding the line that it remains within current provisions, “based on information currently available”, we remain cognizant of further delays to several key B+I projects (pre-fire NZICC included) and have some concern about the possibility of additional losses in the B+I division. The 1H20 update on NZICC timelines and cost will clearly be of key interest to investors.
- **Spot DCF valuation – NZ$4.74, 12-month TP increases to NZ$4.98** (from NZ$4.97) on roll-forward and modest forecast changes. Retain NEUTRAL. Risks: NZ/Aus cycle; Australia turnaround; construction contracts.

Share price performance



On 28-Nov-2019 the NEW ZEALAND EXCH NZSX 50 FREE IDX closed at 11136.65
On 28-Nov-2019 the spot exchange rate was NZ$1.56/US$1

Performance	1M	3M	12M
Absolute (%)	13.38	16.44	10.00
Relative (%)	10.20	12.91	-17.80

Financial and valuation metrics

Year	6/19A	6/20E	6/21E	6/22E
Adjusted Earnings (NZ$ mn)	367	263	289	311
EPS Adjusted (NZc)	43.0	32.0	36.6	39.3
EPS Growth (%)	n.m	(25.6)	14.3	7.5
P/E (x)	12.0	16.2	14.1	13.1
CPS (NZc)	17.9	61.2	96.4	93.4
P/CF (x)	28.8	8.4	5.4	5.5
EV/EBITDA (x)	5.6	5.6	5.6	5.1
Net DPS (NZc)	23.0	24.0	28.0	30.0
Imputation (%)	0.0	0.0	100.0	100.0
Net Yield (%)	4.4	4.6	5.4	5.8
Gross Yield (%)	4.4	4.6	7.5	8.1

Source: Company data, Refinitiv, Jarden estimates

Figure 1: Fletcher Building financial summary

Sector: Capital Goods | **NZX Code: FBU**

PROFIT & LOSS ($m)

Year to 30 Jun	2018A	2019A	2020F	2021F	2022F
Operating Revenue	9,471	9,307	8,115	8,107	8,287
Operating Expenses	-9,207	-8,477	-7,194	-7,164	-7,291
Operating EBITDA	**264**	**830**	**921**	**943**	**996**
Depreciation	-188	-180	-362	-376	-389
Amortisation	-26.0	-19.0	-19.0	-21.4	-23.4
Operating EBIT	**50.0**	**631**	**540**	**545**	**584**
Other Income	0.0	0.0	0.0	0.0	0.0
Abnormals	-168	-234	-30.0	0.0	0.0
Reported EBIT	-118	397	510	545	584
Net Interest	-157	-118	-155	-123	-131
Pretax Profit	-275	279	355	422	453
Tax	96.0	-102	-100	-120	-129
Minority Interests	-11.0	-13.0	-13.0	-13.0	-13.0
Equity Accounted Profit	0.0	0.0	0.0	0.0	0.0
Reported NPAT	**-190**	**164**	**242**	**289**	**311**
Abnormals (net of tax)	-130	-203	-21.5	0.0	0.0
Adjusted Earnings	**-60.0**	**367**	**263**	**289**	**311**

BALANCE SHEET ($m)

Year to 30 Jun	2018A	2019A	2020F	2021F	2022F
Cash & Equivalents	665	1,372	300	300	300
Debtors & Inventories	3,377	2,902	2,865	2,844	2,904
Other Current Assets	91.0	111	111	111	111
Current Assets	**4,133**	**4,385**	**3,276**	**3,255**	**3,315**
Fixed Assets	2,231	1,754	1,860	2,028	1,975
Investments	149	152	152	152	152
Intangibles	1,696	1,129	1,147	1,166	1,178
Other Non-Current Ass.	336	1,790	1,718	1,722	1,729
Total Assets	**8,545**	**9,210**	**8,152**	**8,324**	**8,349**
Interest Bearing Debt	1,938	1,697	1,175	1,226	1,114
Other Liabilities	2,465	3,640	3,388	3,426	3,481
Total Liabilities	**4,403**	**5,337**	**4,564**	**4,651**	**4,595**
Minorities	24.0	32.0	32.0	32.0	32.0
Convertible Capital	0.0	0.0	0.0	0.0	0.0
Ordinary Equity	4,118	3,841	3,556	3,640	3,722
Total Funds Emp.	**8,545**	**9,210**	**8,152**	**8,324**	**8,349**

RATIOS AND CAPITAL STRUCTURE

Year to 30 Jun		2018A	2019A	2020F	2021F	2022F
Profitability & Growth						
EBITDA/Op Rev	%	2.8	8.9	11.4	11.6	12.0
EBIT/Op Rev	%	0.5	6.8	6.7	6.7	7.0
Effective Tax Rate	%	34.9	36.6	28.3	28.4	28.5
Return On Equity	%	-1.6	9.2	7.1	8.0	8.4
ROCE	%	0.9	13.1	12.5	12.0	12.7
EPS Adjusted	c.	-8.1	43.0	32.0	36.6	39.3
EPS Growth	%	-117	-634	-25.6	14.3	7.5
Net DPS	c.	0.0	23.0	24.0	28.0	30.0
Dividend Cover	x		1.9	1.3	1.3	1.3
Asset Backing & Capital Structure						
Net Cash (Debt)	$m	-1,273	-325	-875	-926	-814
NTA / Share	$	2.84	3.18	3.05	3.13	3.22
Equity / Tot Assets	%	48.5	42.1	44.0	44.1	45.0
Net Debt / EBITDA	x	4.8	0.4	1.0	1.0	0.8
Interest Cover	x	0.3	5.3	3.5	4.4	4.5
Shares on Issue						
Ordinary	m	853	853	791	791	791
Fully Diluted	m	853	853	791	791	791

CASH FLOW ($m)

Year to 30 Jun		2018A	2019A	2020F	2021F	2022F
Operating EBITDA		264	830	921	943	996
Other Cash Income		0.0	0.0	0.0	0.0	0.0
Interest Paid		-158	-128	-155	-123	-131
Tax Paid		-85.0	-28.0	-55.5	-113	-125
Working Capital / Other		375	-521	-207	56.1	-1.8
Operating Cash Flow		**396**	**153**	**503**	**762**	**739**
Total Capex		-304	-348	-345	-426	-341
Acquisitions		0.0	-26.0	0.0	0.0	0.0
Divestments		76.0	1,288	0.0	0.0	130
Dividends		-123	-68.0	-226	-205	-229
Equity Raised		727	0.0	-300	0.0	0.0
Other		-15.0	-7.0	-183	-182	-186
Change in Net Debt		**757**	**992**	**-550**	**-50.5**	**112**
Maint Capex	$m	-304	-348	-345	-426	-341
Capex/Depn	%	162	193	95.3	113	87.8
Capex/Rev	%	3.2	3.7	4.2	5.3	4.1

DIVISIONAL EBIT (NZ$m)

Year to 30 Jun	2018A	2019A	2020F	2021F	2022F
NZ Core EBIT	375	348	330	310	301
Res & Devel EBIT	136	137	109	101	98
NZ Construction EBIT	-608	47	53	65	79
NZ ex Corp EBIT	-97	532	493	476	478
Australia EBIT	114	57	53	77	111
International EBIT	65	82	0	0	0
Divested EBIT	13	0	0	0	0
Corporate EBIT	-45	-40	-55	-57	-59
Group EBIT	50	631	491	496	530

KEY DRIVERS

Year to 30 Jun	2018A	2019A	2020F	2021F	2022F
NZ new res. consents	31,087	32,996	30,356	27,776	25,000
NZ non-res WPIP	7,636	7,789	7,944	8,265	8,599
NZ Infrastructure	7,840	8,157	8,528	8,916	9,322
Au new res. consents	223,497	210,933	198,277	186,380	191,972
Au non-res WPIP	43,167	43,816	44,916	46,043	48,420
Au Infrastructure	109,736	103,075	105,137	110,457	116,046

Source: Company data, Jarden estimates

ASM update

Maiden guidance below FY19 and consensus

FBU has today issued maiden FY20 earnings guidance of $515 mn - $565 mn on a post-IFRS16 basis. With FBU having sold its International assets and with FY20 earnings impacted by a change in lease accounting, we calculate FY19 EBIT on a continuing, post-IFRS16 basis as a base against which to measure forecast earnings performance (Figure 2). Deducting the International division and excess Land Development earnings, and adjusting for abnormally low corporate overheads, we estimate base FY19 EBIT of $503 mn, and further adjusting for the changes to lease accounting we calculate post-IFRS16 EBIT of $552 mn.

With the mid-point of the guidance range at $540 mn sitting below FY19A, our previous adjusted forecast of $551 mn and consensus of ~$560 mn we see today's announcement as representing a modest downgrade to expectations for broadly flat earnings.

Figure 2: FY19 base earnings and pre-guidance FY20 forecast, NZ$ mn

	FY19A	FY20E
		Pre-guidance
Norm EBIT pre-IFRS16	**631**	**502**
less: Formica earnings	(82)	
less: Land development excess earnings	(31)	
less: Corporate overhead underspend	(15)	
Base EBIT pre-IFRS16	**503**	**502**
add: Lease expense	234	234
less: Lease depreciation	(185)	(185)
Base EBIT post-IFRS16	**552**	**551**
Consensus EBIT post-IFRS16		~560
Base D&A	174	196
Base EBITDA pre-IFRS16	**677**	**698**
add: Lease expense	234	234
Base EBITDA post-IFRS16	**911**	**932**

Source: Company data, Jarden estimates

Trading update and outlook

In NZ finishing trade volumes remain strong, supporting the wallboards, insulation and laminates businesses. Activity levels in the key residential sector are forecast to ease through the remainder of the year. The Steel division remains under pressure in a highly competitive market and civil/infrastructure activity is trending lower in the early trades, impacting concrete and pipes – modestly at this point.

In Australia infrastructure delays have impacted trading in the year to date and FBU highlights ongoing pricing pressure in Stramit and Tradelink. Whilst residential consents continue to decline FBU maintains the view that these are likely to bottom out in FY20 with a strong rebound forecast through FY23. Against this backdrop FBU remains committed to its Australian turnaround programme as it targets 7% EBIT margins over the medium term through a combination of operational efficiency improvements, product innovation and digitization. In FY20, FBU is targeting $15 mn of cost out benefits (weighted to the second half) with a further $50 mn of net benefits in FY21. However, with FY19 margins at ~2%, ROFE at just 3% (pre-tax) and FBU looking to invest at elevated levels (~$90 mn p.a.) it will likely be several years before the Australian division is generating economic returns on its invested capital.

Understandably, FBU offered relatively little by way of update on NZICC as it looks to assess the damage caused by the recent fire and to determine the impact on cost and programme. FBU confirmed that it remains within the provisions announced in February 2018 on the information currently available noting that Contract Works and Third Party Liability insurances will respond to loss and damage. A further update is expected at the 1H20 result in February.

Forecasts and revisions

We present our updated forecasts in Figure 3 and show changes in Figure 4.

With guidance broadly in line with our previous forecasts and FBU's stated FY20 metrics unchanged from the FY19 result, we update our divisional forecasts resulting in relatively modest changes at the Group level. After introducing IFRS16, key changes to our forecasts include:

- A modest reduction in FY20 and FY21 Steel earnings on ongoing competitive intensity and a more gradual return to mid-cycle margins from FY22.
- A reduction in Construction earnings with FBU guiding to stable earnings in this division and citing wet weather delays in 1Q20.
- A modest reduction in near-term earnings in Australia on heightened margin pressures in Stramit and Tradelink and Infrastructure delays impacting the building products businesses.

Figure 3: Summary financials, NZ$ mn

Y/e 30 June	FY19A	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F
Sales (external)	**9,307**	**8,115**	**8,107**	**8,287**	**8,731**	**9,131**	**9,578**	**10,016**	**10,475**	**10,914**
Operating expenses	(8,690)	(7,575)	(7,562)	(7,703)	(8,076)	(8,412)	(8,811)	(9,201)	(9,611)	(10,015)
Other income / expenses	14	-	-	-	-	-	-	-	-	-
Total operating expenses (net)	(8,676)	(7,575)	(7,562)	(7,703)	(8,076)	(8,412)	(8,811)	(9,201)	(9,611)	(10,015)
EBIT pre-unusuals	**631**	**540**	**545**	**584**	**654**	**719**	**768**	**815**	**864**	**899**
Unusual / significant items	(234)	(30)	-	-	-	-	-	-	-	-
EBIT	**397**	**510**	**545**	**584**	**654**	**719**	**768**	**815**	**864**	**899**
Funding costs	(118)	(155)	(123)	(131)	(129)	(126)	(120)	(119)	(116)	(114)
NPBT	279	355	422	453	525	593	647	696	748	785
Tax expense	(102)	(100)	(120)	(129)	(150)	(169)	(184)	(198)	(213)	(224)
Earnings after taxation	177	255	302	324	375	424	463	498	535	561
Earnings to non-controlling interests	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)	(13)
NPAT	**164**	**242**	**289**	**311**	**362**	**411**	**450**	**485**	**522**	**548**
Norm. EBIT continuing, pre-IFRS16										
NZ including corporate	492	438	419	419	443	457	477	503	530	542
Australia	57	53	77	111	145	185	202	212	222	233
EBIT continuing, pre-IFRS16	**549**	**491**	**496**	**530**	**588**	**642**	**679**	**715**	**751**	**774**
Revenue growth	(1.7%)	(12.8%)	(0.1%)	2.2%	5.4%	4.6%	4.9%	4.6%	4.6%	4.2%
EBIT margin (pre-IFRS16)	5.9%	6.0%	6.1%	6.4%	6.7%	7.0%	7.1%	7.1%	7.2%	7.1%
EBITDA margin (pre-IFRS16)	8.9%	8.5%	8.8%	9.1%	9.4%	9.7%	9.7%	9.7%	9.7%	9.6%
Norm. EBITDA reported	830	921	943	996	1,076	1,148	1,203	1,258	1,316	1,359
less: Lease expense		(234)	(234)	(239)	(252)	(263)	(276)	(289)	(302)	(315)
Norm. EBITDA pre-IFRS16	**830**	**687**	**709**	**757**	**824**	**884**	**927**	**969**	**1,014**	**1,045**
Norm. NPAT reported	367	263	289	311	362	411	450	485	522	548
D&A ex IFRS16	(199)	(196)	(213)	(227)	(236)	(242)	(248)	(255)	(262)	(270)
Capex	348	320	351	311	287	285	299	313	327	342
Shares on issue (mn, year end)	853	791	791	791	791	791	791	791	791	791
Normalised EPS (cps)	43	32	37	39	46	52	57	61	66	69
Declared DPS (cps)	23	24	28	30	32	36	40	42	46	48
Payout (vs normalised NPAT)	53.5%	73.6%	76.6%	76.3%	69.8%	69.3%	70.3%	68.5%	69.7%	69.3%
Operating cash flow	153	503	762	739	772	851	863	908	953	971
Lease principal	-	(170)	(169)	(173)	(186)	(197)	(210)	(223)	(237)	(251)
Op cash flow after leases	**153**	**334**	**594**	**565**	**586**	**654**	**653**	**685**	**716**	**720**
Capex (net)	(343)	(345)	(426)	(211)	(287)	(285)	(299)	(313)	(327)	(342)
Free cash flow, ex acq's/divestment	**(190)**	**(11)**	**168**	**354**	**299**	**370**	**354**	**373**	**389**	**378**
Acquisitions / divestments	1,257	-	-	-	-	-	-	-	-	-
Dividends	(68)	(226)	(205)	(229)	(245)	(268)	(300)	(324)	(347)	(371)
Free cash flow after dividends	**999**	**(237)**	**(38)**	**125**	**54**	**101**	**54**	**49**	**42**	**7**
Net debt	**(325)**	**(875)**	**(926)**	**(814)**	**(772)**	**(684)**	**(643)**	**(607)**	**(578)**	**(584)**
Net debt/EBITDA pre-IFRS16	0.4x	1.3x	1.3x	1.1x	0.9x	0.8x	0.7x	0.6x	0.6x	0.6x
Funds employed	**4,113**	**4,477**	**4,659**	**4,673**	**4,761**	**4,836**	**4,919**	**5,008**	**5,107**	**5,216**
ROFE (Base business)	12.6%	11.0%	10.7%	11.4%	12.4%	13.3%	13.8%	14.3%	14.8%	14.9%

Source: Company data, Jarden estimates

Figure 4: Forecast revisions, NZ$ mn

Y/e 30 June	FY20F	FY21F Was	FY22F	FY20F	FY21F Now	FY22F	FY20F	FY21F Chg	FY22F
External sales	**8,115**	**8,107**	**8,287**	**8,115**	**8,107**	**8,287**	**-**	**-**	**-**
EBIT pre-unusuals, pre-IFRS16									
Concrete	91	85	79	91	85	79	-	-	-
Building Products	116	112	106	116	112	106	-	-	-
Distribution	90	81	78	90	81	78	-	-	-
Steel	34	34	46	33	33	39	(4.4%)	(4.0%)	(16.7%)
NZ Core	**332**	**312**	**309**	**330**	**310**	**301**	**(0.4%)**	**(0.4%)**	**(2.5%)**
Construction	61	73	83	53	65	79	(12.0%)	(10.8%)	(5.7%)
Residential & Development	109	101	98	109	101	98	-	-	-
Australia	55	79	112	53	77	111	(3.9%)	(2.1%)	(1.1%)
Corporate	(55)	(57)	(59)	(55)	(57)	(59)	-	-	-
EBIT pre-unusuals , pre-IFRS16	**502**	**507**	**543**	**491**	**496**	**530**	**(2.2%)**	**(2.1%)**	**(2.5%)**
IFRS16 adjustment	49	49	54	49	49	54	-	-	-
EBIT pre-unusuals, post-IFRS16	**551**	**556**	**598**	**540**	**545**	**584**	**(2.0%)**	**(2.0%)**	**(2.3%)**
Significant items	(30)	-	-	(30)	-	-	-	-	-
Reported EBIT	**521**	**556**	**598**	**510**	**545**	**584**	**(2.1%)**	**(2.0%)**	**(2.3%)**
Funding costs (net)	(90)	(58)	(64)	(91)	(58)	(65)	0.3%	0.7%	1.8%
Lease interest	(64)	(65)	(65)	(64)	(65)	(65)	-	-	-
NPBT	366	433	468	355	422	453	(3.0%)	(2.6%)	(3.2%)
Tax	(104)	(123)	(133)	(100)	(120)	(129)	(3.0%)	(2.6%)	(3.2%)
Earnings after taxation	**263**	**310**	**335**	**255**	**302**	**324**	**(3.0%)**	**(2.6%)**	**(3.2%)**
Earnings to minority interests	(13)	(13)	(13)	(13)	(13)	(13)	-	-	-
NPAT	**250**	**297**	**322**	**242**	**289**	**311**	**(3.2%)**	**(2.7%)**	**(3.3%)**
EPS (normalised)	33	38	41	32	37	39	(2.9%)	(2.7%)	(3.3%)
DPS (cps)	24	28	30	24	28	30	-	-	-
D&A ex IFRS16	(196)	(213)	(227)	(196)	(213)	(227)	-	-	-
Operating cash flow	509	772	748	503	762	739			
Lease principal	(170)	(169)	(173)	(170)	(169)	(173)	-	-	-
Op cash flow after leases	**339**	**603**	**575**	**334**	**594**	**565**	**(1.6%)**	**(1.6%)**	**(1.6%)**
Investing cash flows	(345)	(426)	(211)	(345)	(426)	(211)	-	-	-
Free cash flow after leases	**(6)**	**178**	**363**	**(11)**	**168**	**354**	**95.5%**	**(5.5%)**	**(2.6%)**
Net debt	**(870)**	**(911)**	**(789)**	**(875)**	**(926)**	**(814)**	**0.6%**	**1.7%**	**3.1%**

Source: Company data, Jarden estimates

Valuation and risks

We use a spot DCF valuation methodology to derive our 12-month target price for FBU, which involves a roll-forward of spot DCF by cost of equity less dividends. Our explicit forecasts extend out to FY28 and we apply a terminal value thereafter. Key parameters in our DCF valuation include a terminal growth rate of 2% and a long-term WACC of 9.7% (asset beta 0.85; equity beta 0.9; risk free rate 4.6%; market risk premium 7.4%). We summarise our base-case DCF valuation in Figure 5.

Figure 5: FBU valuation, NZ$ mn

Valuation summary	
PV of discrete cash flows	1,889
PV of terminal value	2,763
Enterprise value	4,652
Net debt	(552)
Minority interest	(156)
Equity value	3,944
Shares on issue - mn	832.1
Equity value per share - NZ$	4.74

Source: Company data, Jarden estimates

Our base-case spot DCF valuation is $4.74, our 12-month price target increases from $4.97 to $4.98 and our rating remains unchanged at NEUTRAL. Our forecasts take a constructive view on the new strategy and an eventual turnaround in the performance of the Australian business, with investment factored in to support this, but we highlight the difficult path ahead with market activity levels in decline. We do not forecast a downturn in the NZ construction sector, but we do factor in a reversion to mid-cycle levels over the next three years. In our view, positive catalysts for the stock include:

- A more sustained cyclical upturn in the NZ residential sector, that leads to a basis on which to assume a higher level of mid-cycle activity. We distinguish between upside associated with this cycle being stronger for another two or three years, and the real valuation uplift that would come from believing in structurally higher activity.
- FBU's ability to manage the wind-down of the existing portfolio of B+I projects within the current provisions and a focus on more profitable, lower-risk projects in the continuing construction businesses.
- Greater confidence in FBU's ability to improve returns in the Australian division. FBU plans to invest in the existing businesses over the next few years, with a view to recapturing market share and returning to acceptable operating margins. The ability to execute on this strategy, before moves into adjacencies, is key to building confidence. With the onset of what could be a major downturn in the Australian residential sector, that turnaround may take longer and be more challenging.

Risks

Key downside risks for FBU include—a change in NZ and Australian construction activity levels, new entrants into the NZ and Australian markets, import competition, further losses in key construction/infrastructure contracts, poor execution on capital expenditure or M&A, and currency movements for materials purchased in foreign currencies. The key upside risks are a longer and stronger NZ building cycle and margin expansion on greater efficiencies/more benign competitive environment in Australia.

Investment overview

Investment view

FBU is emerging from a major reset of the business, which saw it record up to $1 bn in onerous contract losses; raise $750 mn of equity to address balance sheet issues; announce the simplification of the business in NZ and Australia with divestment of $1 bn of international assets (now completed); and acknowledge that turning around the underperforming Australian businesses requires investment into a division generating poor returns that is not without risk. Through this recent period, the core NZ business has performed well, but we note abnormally high earnings from the Residential & Development business in FY18 and FY19, and at least some potential for the Building Products and Distribution businesses to see some moderation in earnings if the robust NZ cycle turns. We take a positive view on an eventual turnaround in Australia, but highlight the difficult path ahead with market activity levels in decline. We factor in reversion to mid-cycle activity levels in NZ. Even with a positive view on a structurally higher NZ construction sector, we are mindful of risks, which include FBU's significant operating leverage to the NZ cycle and a need to still execute on the Australian turnaround. We believe that FBU is still some time away from executing the turnaround and do not expect any material M&A until it is more progressed, with lessons here from the past too. NEUTRAL.

Valuation method

Our rating is NEUTRAL with a NZ$4.98 target price based on roll forward of our spot DCF valuation (WACC 9.7%; asset beta 0.85) at the cost of equity less dividends. Our valuation is underpinned by a positive view on an eventual turnaround in Australia and an assumption for a reversion to mid-cycle activity levels for the key NZ businesses. Upside catalysts to our rating include increased confidence that the NZ cycle is subject to higher long-term structural activity levels; and strong early progress on a turnaround of the Australian business.

Risks

Key downside risks to our NZ$4.98 target price and NEUTRAL rating for FBU include—a change in NZ and Australian construction activity levels; new entrants into the NZ and Australian markets; import competition; further losses in key construction/infrastructure contracts; poor execution on capital expenditure or M&A; and currency movements for materials purchased in foreign currencies. The key upside risks are a longer and stronger NZ building cycle and margin expansion on greater efficiencies/more benign competitive environment in Australia.

Limitations & Disclaimer - Sales & Research

This publication has been prepared by Jarden Securities Limited ("Jarden") for distribution to clients of Jarden on the basis that no part of it will be reproduced, altered in any way, transmitted to, copied to or distributed to any other person without the prior express permission of Jarden.

The information, investment views and recommendations in this publication are provided for general information purposes only. To the extent that any such information, views, and recommendations constitute advice, they do not take into account any person's particular financial situation or goals and, accordingly, do not constitute personalised financial advice under the Financial Advisers Act 2008, nor do they constitute advice of a legal, tax, accounting or other nature to any person. We recommend that recipients seek advice specific to their circumstances from their adviser before making any investment decision or taking any action.

This publication does not, and does not attempt to, contain all material or relevant information about the subject companies or other matters herein. The information is published in good faith and has been obtained from sources believed to be reliable, accurate and complete at the time of preparation, but its accuracy and completeness is not guaranteed (and no warranties or representations, express or implied, are given as to its accuracy or completeness). To the fullest extent permitted by law, no liability or responsibility is accepted for any loss or damage arising out of the use of or reliance on the information provided including without limitation, any loss of profit or any other damage, direct or consequential. Information, opinions and estimates contained herein reflect a judgement at the date of publication by Jarden and are subject to change without notice. Jarden is under no obligation to update or keep current any of the information on this publication.

Research may include material sourced from Credit Suisse Group. To the fullest extent permitted by law, Credit Suisse Group shall have no liability to Jarden or clients or prospective clients of Jarden or any other person in relation to such research material.

All investment involves risk. The bond market is volatile. Bonds carry interest rate risk (as interest rates rise, bond prices usually fall, and vice versa), inflation risk and issuer and credit default risks. Lower quality and unrated debt securities involve a greater risk of default and/or price changes due to potential changes in the credit quality of the issuer. The price, value and income derived from investments may fluctuate in that values can go down as well as up and investors may get back less than originally invested. Past performance is not indicative of future results, and no representation or warranty, express or implied, is made regarding future performance or investment returns. Reference to taxation or the impact of taxation does not constitute tax advice. The levels and bases of taxation may change. The value of any tax reliefs will depend on investors' circumstances. Investors should consult their tax adviser in order to understand the impact of investment decisions on their tax position. Where an investment is denominated in a foreign currency, changes in rates of exchange may have adverse effect on the value, price or income of the investment. The market in certain investments may be unavailable and/or illiquid meaning that investors may be unable to purchase, sell or realise their investments at their preferred volume and/or price, or at all.

Jarden, its employees and persons associated with Jarden may (i) have held or hold securities mentioned in this publication (or related securities) as principal for their own account, (ii) have provided investment advice or other investment services in relation to such securities within the last twelve months, and (iii) have other financial interests, including as a shareholder of the Jarden Group group of companies, in the matters mentioned herein. Investors should assume that Jarden, its related companies and affiliated persons and Credit Suisse Group, with whom Jarden Group has a strategic alliance, do and seeks to do investment banking business with companies covered in its research reports. Specific additional disclosures will be made in relation to companies where Jarden Group has a transaction role and publishes research.

This publication is intended for distribution only to market professional, institutional investor and retail investor clients in New Zealand and other jurisdictions to whom, under relevant law, this publication lawfully may be distributed. It may not be distributed in any other jurisdiction or to any other persons. Jarden Securities Limited is a NZX Firm.

A Disclosure Statement is available on request, free of charge.